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court's statement that the alleged negligence occurred "in the course of use of the premises for the purpose for which it was leased."<sup>32</sup> This seems to indicate that the defendant would not have been found liable had the sublessee's negligence occurred in some use of the premises not contemplated by the parties to the sublease. Also, there is an implication that a tenant's liability for his sublessee's willful injury of the premises would depend upon some principle analogous to the scope and course of employment doctrines of agency law.<sup>33</sup> At any rate, due to the existence of a formidable new risk on the lessee, and the possible limitations on its application in protection of the landlord, both parties would be prudent to see that leases made in North Carolina deal specifically with the question of waste by the sublessee.

DAVID B. SENTELLE

### Securities Regulations—An Antitrust Challenge to the Minimum Commission Rates of the New York Stock Exchange

When the New York Stock Exchange was organized in 1792, one of the avowed purposes of its founders was the establishment of minimum commission rates to be charged to customers. Such minimum commission schedules have remained in effect since that date with only the methods of computation undergoing any alterations.<sup>1</sup>

In the recent case of *Kaplan v. Lehman Bros.*<sup>2</sup> an antitrust challenge was posed to these rates for the first time since their inception. The plaintiffs, shareholders in five mutual funds, brought the action as a shareholders derivative suit and at the same time as a representative class action alleging that the minimum commission rates<sup>3</sup> imposed by the defendant New York Stock Exchange and

<sup>32</sup> 265 N.C. at 128, 143 S.E.2d at 284.

<sup>33</sup> See *Chappell v. Dean*, 258 N.C. 412, 128 S.E.2d 830 (1963); *Travis v. Duckworth*, 237 N.C. 471, 75 S.E.2d 309 (1953); *Marlowe v. Bland* 154 N.C. 140, 69 S.E. 752 (1910).

<sup>1</sup> Securities and Exchange Commission, *Report of the Special Study of the Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, at 295-96 (1963).

<sup>2</sup> 250 F. Supp. 562 (N.D. Ill. 1966).

<sup>3</sup> Article XV, § 2 of the constitution of the New York Stock Exchange provides for the following minimum commissions to be charged to non-members on round lots:

charged by four defendant members were in violation of section one of the Sherman Act.<sup>4</sup> The district court granted defendants' motion for summary judgment, holding that an antitrust action was not the proper remedy since the fixed commission rates were subject to regulation by the SEC.<sup>5</sup>

The court's reasoning necessarily embodied a full discussion of the implications of *Silver v. New York Stock Exch.*<sup>6</sup> in which the Supreme Court of the United States upheld an earlier antitrust suit brought against the Exchange. In that case the court held that where the Exchange revoked a nonmember broker-dealer's direct wire service with member firms and with the Exchange without giving the nonmember either reason for or notice of such revocation, the defendant Exchange was liable for a violation of sections one and two<sup>7</sup> of the Sherman Act. Mr. Justice Goldberg, writing for the majority, stated that anticompetitive restraints imposed by the Exchange would clearly violate "the Sherman Act unless justified by reference to the purposes of the Securities Exchange Act, and . . . that that statute affords no justification for anticompetitive collective action taken without according fair procedures."<sup>8</sup> Thus, while it is clear that the Exchange Act standing by itself does not grant the Exchange immunity to the antitrust laws, the emphasis of the decision in *Silver* was on the lack of procedural safeguards in the area in controversy.

The court in *Kaplan* interpreted the *Silver* decision as holding that no actions by the Exchange in restraint of competition are per se in violation of the Sherman Act as long as it is acting pursuant to its rule making authority.<sup>9</sup> Therefore, since the plaintiff's based

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2% on first \$400 of money involved plus  
 1% on next \$2,000 of money involved plus  
 1/2% on next \$2,600 of money involved plus  
 1/10% on money involved above \$5,000  
 plus \$3.00

Constitution of the N.Y. Stock Exch., 2 CCH N.Y. STOCK EXCH. GUIDE ¶ 1702.

<sup>4</sup> 50 Stat. 693 (1937), as amended, 15 U.S.C. § 1 (1964). The applicable part of the section is, "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . ."

<sup>5</sup> 250 F. Supp. at 566.

<sup>6</sup> 373 U.S. 341 (1963).

<sup>7</sup> 26 Stat. 209 (1890), as amended, 15 U.S.C. § 2 (1964).

<sup>8</sup> 373 U.S. at 364.

<sup>9</sup> 250 F. Supp. at 564.

their action on the per se theory, the *Silver* decision foreclosed any recovery.<sup>10</sup>

The court further indicated that the decision would have been the same even if the plaintiffs had not relied solely on a per se violation theory. A major distinction between *Silver* and *Kaplan* is that the latter case involved a situation where certain procedural safeguards had been provided by the Exchange Act, whereas in the former case these were lacking. Section 19(b)<sup>11</sup> authorizes SEC review and regulation of thirteen enumerated matters, ninth of which encompasses "the fixing of reasonable rates of commission, interest, listing, and other charges."<sup>12</sup> In *Kaplan* the court reasoned that provision for such review remedied the situation that the Supreme Court complained of in *Silver*—the lack of procedural safeguards.<sup>13</sup>

The *Kaplan* case illustrates a basic dilemma presented by the clash of two conflicting policies embodied in the antitrust laws and the Exchange Act. On the one hand the Sherman Act favors the protection of free competition, while the Exchange Act provides for self-regulation by the Exchange which necessarily includes the anti-competitive effects of concerted action.<sup>14</sup> There is no specific exemption of Exchanges to antitrust liability contained in the Exchange Act.<sup>15</sup> Nor can such immunity be implied on the theory that the passage of the Exchange Act impliedly repealed repugnant sections of the antitrust laws.<sup>16</sup> Congress worked out the statutory

<sup>10</sup> *Id.* at 565.

<sup>11</sup> 48 Stat. 898-99 (1934), as amended, 15 U.S.C. § 78s(b) (1964).

<sup>12</sup> 48 Stat. 899 (1934), 15 U.S.C. § 78s(b)(9) (1964).

<sup>13</sup> "Since review is afforded within the system of securities regulation, there is no need to resort to the antitrust laws for a remedy." 250 F. Supp. at 566.

<sup>14</sup> Nerenberg, *Applicability of the Antitrust Laws to the Securities Field*, 16 W. RES. L. REV. 131, 134 (1964) [hereinafter cited as Nerenberg].

<sup>15</sup> In contrast, the Maloney Act, which deals with associations of over-the-counter dealers, provides as follows: "If any provision of this section is in conflict with any provision of any law of the United States in force on June 25, 1938, the provision of this section shall prevail." 52 Stat. 1075 (1938), 15 U.S.C. § 78o-3(n) (1964).

At the same time the Act authorizes the Commission to refuse registration to any association whose actions are not consistent with free and competitive markets—the fundamental objective of the antitrust laws. 52 Stat. 1071 (1938), 15 U.S.C. § 78o-3(b)(8) (1964).

<sup>16</sup> "It is a cardinal principle of construction that repeals by implication are not favored." *Silver v. New York Stock Exch.*, 373 U.S. 341, 357 (1963); *United States v. Borden Co.*, 308 U.S. 188, 198 (1939). *Accord*, *Georgia v. Pennsylvania R.R. Co.*, 324 U.S. 439, 456-57 (1945); *General Motors Acceptance Corp. v. United States*, 286 U.S. 49, 61-62 (1932).

scheme to regulate securities with antitrust problems in mind; they provided no exemption from antitrust laws and it is hardly probable that they inadvertently failed to do so.<sup>17</sup> But Congress did bestow a "federally mandated duty of self-policing" on the Exchanges.<sup>18</sup> To carry out this duty, the Exchanges must be allowed a certain degree of control over their members. Such control necessitates the imposition of uniform rules and regulations, resulting in concerted action by the member firms.<sup>19</sup> If such concert is not protected in some measure by the Exchange Act, an antitrust violation will result.<sup>20</sup>

In an attempt to resolve the conflict of policies, the court in *Silver* seems to have decided that while the Exchange is not immune to antitrust regulation and while actions taken pursuant to self regulation are not per se violations of the Sherman Act, protection from liability requires a showing that the action is in furtherance of the purposes of the Exchange Act<sup>21</sup> and that procedural safeguards including review by the SEC are provided.<sup>22</sup>

As the court in *Kaplan* pointed out, section 19(b) of the Exchange Act provides a procedural remedy by subjecting the minimum commission rates to review by the SEC.<sup>23</sup> But this remedy has been virtually ignored; in the entire history of the statute only one formal proceeding involving this section has been brought.<sup>24</sup> Subsection nine was not involved in that action<sup>25</sup> and it appears that there have been few, if any, complaints of the commissions charged. As an additional safeguard, section 25(a) of the Exchange Act provides for review of SEC decisions by the Court of Appeals of

<sup>17</sup> *United States v. Morgan*, 118 F. Supp. 621, 697 (S.D.N.Y. 1953).

<sup>18</sup> *Silver v. New York Stock Exch.*, 373 U.S. 341, 352 (1963).

<sup>19</sup> Proposed Legislation—Antitrust Laws Immunity, 3 CCH N.Y. STOCK EXCH. GUIDE ¶ 5212.

<sup>20</sup> *Nerenberg* 134.

<sup>21</sup> The principal purposes of the Exchange Act are "to insure fair dealing and to protect investors." 48 Stat. 886 (1934), 15 U.S.C. § 78f(d) (1964).

<sup>22</sup> 373 U.S. at 364.

<sup>23</sup> 48 Stat. 889 (1934), 15 U.S.C. § 78s(b) (1964).

<sup>24</sup> 2 LOSS, SECURITIES REGULATIONS 1182 (2d ed. 1961).

<sup>25</sup> The New York Stock Exchange had passed a rule subjecting members to expulsion or suspension for "multiple trading," i.e., for trading in Exchange listed stocks on other exchanges for the member's own account. The Commission ruled that certain changes would have to be made in the rule to prevent a violation of a basic purpose of the Act—"a purpose which is closely related to the public policy regarding unreasonable restraints and the maintenance of fair competition . . ." Rules of the New York Stock Exch., 10 S.E.C. 270, 287 (1941).

the circuit in which the aggrieved party has his residence or his principal place of business.<sup>26</sup>

The court in *Kaplan* neglected to discuss the other requirement enumerated by *Silver* for protection from antitrust liability—that the concerted action be in pursuance of the purposes of the Exchange Act. It would appear that the setting of such minimum rates, which in reality act as fixed rates, would serve to protect investors in that both small and large investors are charged the same rates. In the absence of such fixed minimums, the charge to the small investor in relation to the large investor might become disproportionately increased so that the small buyer would be effectively pushed out of the market. Another advantage of minimum commission rates is that they facilitate an audit of a member's income and thereby increase the effectiveness of control exercised by the commission. Furthermore, while minimum rates reduce price competition among members, they serve to increase competition "in ancillary services such as furnishing research, investment advice and quotations, safekeeping of securities, and collecting dividends."<sup>27</sup>

However, there are persuasive arguments in favor of subjecting the minimum commission rates to antitrust regulation. In *United States v. National Ass'n of Real Estate Boards*<sup>28</sup> the Court held that an agreement among members of a real estate board to maintain standard rates was per se a violation of the Sherman Act. The Court declared that, "an agreement, shown either by adherence to a price schedule or by proof of consensual action fixing the uniform or minimum price, is itself illegal under the Sherman Act, no matter what end it was designed to serve."<sup>29</sup> Certainly, the *Kaplan* situation can be distinguished on the basis that the defendants there were subject to the Exchange Act. Since the *Silver* case seemingly indicates that an Exchange or Exchange member that is subject to

<sup>26</sup> 48 Stat. 901-02 (1934), as amended, 15 U.S.C. § 78y (1964). In order for a decision of the SEC to be reviewable under § 25(a) the Commission's action must be in the form of a *final* order. *SEC v. Andrews*, 88 F.2d 441 (2d Cir. 1937).

<sup>27</sup> *Nerenberg* 149.

<sup>28</sup> 339 U.S. 485 (1950).

<sup>29</sup> *Id.* at 489; *Accord*, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940). *But cf.*, *Board of Trade v. United States*, 246 U.S. 231, 238 (1918). "The true test of legality [of a restraint of trade] is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition."

the Exchange Act is not liable per se for an antitrust violation,<sup>30</sup> it would appear that the distinction is valid. Nevertheless, *Silver* did not deal with minimum commission rates and its broad language might not be sufficient to protect the Exchange in the face of the strong declaration of antitrust policy by the court in *Real Estate Boards*.<sup>31</sup> It is submitted that the Court may require a stronger justification for the minimum rates before it follows the district court decision.

The argument that minimum rates increase competition in ancillary services might appear at first blush to justify the commission schedule. However, since the more costly special services such as direct wires and elaborate analytical and statistical information<sup>32</sup> are normally offered only to large customers, the commission rates have the effect of causing many small investors to pay for services not rendered to them. Furthermore, the small investor cannot remedy his plight by taking his business elsewhere since the charges must necessarily remain the same.<sup>33</sup>

The application of minimum commission rates to nonmember broker-dealers may have an even greater damaging effect upon competition. A nonmember broker-dealer pays the same commission rate to a member firm for listed securities that his customer would pay had he originally placed his order with the member. The nonmember is unable to charge his customer a rate in excess of the minimum because the competition of the member firms would draw the customer away. The result of such a transaction is that the nonmember receives a commission exactly equal to the one he paid to a member firm.<sup>34</sup> Thus, he not only fails to make a profit on the transaction, but he also has no margin to cover basic operating expenses. Moreover, if he refuses to handle such a transaction, he is liable to lose his customer's business altogether.<sup>35</sup>

It appears that justification for minimum commission rates set

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<sup>30</sup> 373 U.S. at 348.

<sup>31</sup> 339 U.S. 485 (1950).

<sup>32</sup> Securities and Exchange Commission, *Report of the Special Study of the Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, at 312 (1963).

<sup>33</sup> Nerenberg 149.

<sup>34</sup> Furthermore, the constitution of the Exchange prohibits rebates to or fee splitting with nonmembers. Constitution of the N.Y. Stock Exch., 2 CCH N.Y. STOCK EXCH. GUIDE ¶ 1708.

<sup>35</sup> Securities and Exchange Commission, *Report of the Special Study of the Securities Markets*, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, at 312 (1963).

by the New York Exchange is at best open to question. The right to have such rates reviewed by the SEC is in reality illusory since that review is of the reasonableness of the commissions and presupposes a fixed minimum. It is not the reasonableness that should be questioned but rather the very existence of minimums imposed by an exchange upon its members. Mr. Nerenberg<sup>36</sup> suggests that

strictly as a matter of antitrust law, the existence of so important and pervasive a structure of commission rates ought to rest on a sounder legal foundation. If there is sufficient economic justification to insist upon a minimum rate structure, then classification by way of a limited antitrust exemption by statute would be appropriate. Otherwise, in the absence of further regulatory control by the Commission, it would appear that the present rate structure may be susceptible to antitrust enforcement.<sup>37</sup>

The Chairman of the SEC, Mr. Cohen, also suggests that legislation should be passed to resolve sensitive and complex questions "to correct any failure to afford proper weight to antitrust policies."<sup>38</sup> Cohen further believes that Congress should pass legislation similar to the Maloney Act<sup>39</sup> that would apply to exchange markets. Such legislation should incorporate standards relating to the antitrust field; once such standards are included, Congress should exempt the Exchange and its members from antitrust liability for actions that conform with the Act.<sup>40</sup>

If Congress does not act there may well be a number of other antitrust challenges to the actions of the Exchange. Some of the likely areas of dispute are as follows:

1. Exchange Rule 394<sup>41</sup> that prohibits Exchange members from trading listed securities in the over-the-counter market without special permission from the Exchange.
2. Prohibition of fee splitting;<sup>42</sup> *i.e.*, splitting a commission with a nonmember broker-dealer.

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<sup>36</sup> Mr. Nerenberg is an attorney with the Office of the General Counsel for the SEC.

<sup>37</sup> Nerenberg 151.

<sup>38</sup> Proposed Legislation—Antitrust Laws Immunity, 3 CCH N.Y. STOCK EXCH. GUIDE ¶ 5238.

<sup>39</sup> See note 15 *supra*.

<sup>40</sup> Nerenberg 151.

<sup>41</sup> Off-Floor Transactions in Listed Stocks, 2 CCH N.Y. STOCK EXCH. GUIDE ¶ 2394.

<sup>42</sup> Nerenberg 149.



3. "Allegedly restrictive policies governing admission to membership," specifically, the exclusion of mutual funds.<sup>43</sup>

While this is by no means an exhaustive list of problem areas, it should serve to emphasize Mr. Cohen's point that congressional action is needed to achieve a balance between the antitrust policy of insuring free and unrestrained competition and the Exchange Act policy of self-regulation.

CHARLES E. ELROD, JR.

### Taxation—Effect of State Court Adjudications in Federal Tax Litigation

From at least as early as the Supreme Court decision in *Freuler v. Helvering*<sup>1</sup> there has been great uncertainty and even conflict among the lower federal courts as to the extent to which those courts, when making determinations of federal tax liability, should be bound by lower state court adjudications of property rights. In *Freuler* the Commissioner of Internal Revenue argued that any state property decision reached in a collusive proceeding be denied conclusiveness in regard to federal tax liability. The Commissioner defined a collusive proceeding as one in which "all the parties joined in a submission of the issues and sought a decision which would adversely affect the Government's right to additional . . . tax."<sup>2</sup> The Court neither accepted nor rejected the Commissioner's proposed test for collusiveness and decided for the taxpayer by upholding the state decision because of the presence of certain circumstances which the Court apparently deemed to be controlling.<sup>3</sup> By basing its decision on those circumstances, the Court gave little guidance to lower courts in the way of general principles to be followed, and its

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<sup>43</sup> Wall Street Journal, March 26, 1965, p. 3, col. 1.

<sup>1</sup> 291 U.S. 35 (1934).

<sup>2</sup> *Id.* at 45.

<sup>3</sup> The circumstances were that the case appears to have been initiated by the filing of a trustee's account, in the usual way. Notice was given to the interested parties. Objections to the account were presented, and the matter came on for hearing in due course, all parties being represented by counsel. The decree purports to decide issues regularly submitted and not to be in any sense a consent decree.

*Id.* at 45.